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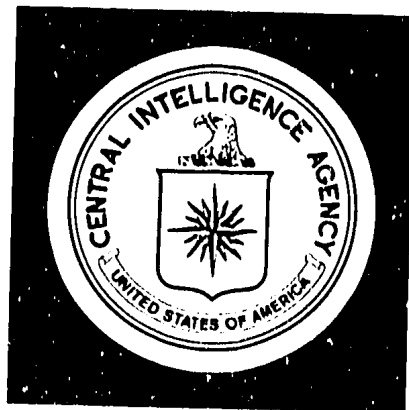
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Intelligence Memorandum

Chinese Economic Prospects for 1974-75

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ER IM 74-1

February 1974

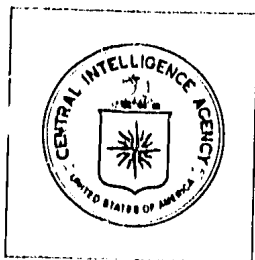
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February 1974

Chinese Economic Prospects for 1974-75

Key Judgments

In 1974 and 1975, the last two years of the Fourth Five-Year Plan, the Chinese economy will move forward at a moderate pace, forging closer ties with the United States, Japan, and Western Europe.

Investment

The great new spurt of interest in foreign equipment and technology -- China contracted for US \$1.2 billion worth of Western industrial plants in 1973 -- will color the investment scene for the remainder of the decade. The domestic political difficulties of the first two months of 1974 could upset this process, although, on balance, we think new contracts will continue to be signed through 1974-75.

Food Imports

The record 7.5 million metric tons of grain imports of 1973 (as contrasted with a normal 5 million tons) will be more than matched by imports already arranged for 1974. The US share in both years is more than 4 million tons.

Foreign Debt

In order to finance its expanding imports of capital plant, Peking has relaxed its longstanding policy of no foreign debt although not to the point where debt servicing will be burdensome.

Agriculture

Agricultural production in 1974-75 will again benefit from increased inputs from the modern sector of the economy -- chemical fertilizer, pumps, pesticides, tractors, and the like.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [REDACTED] of the Office of Economic Research, Code 143.

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Population Pressure

Even though Peking is vigorously promoting population control measures, they will have little effect on demographic rates in the near term, and population will continue to push against the means of subsistence.

Petroleum

The pace of expansion of the rapidly growing petroleum industry was further accelerated in 1973 when production accelerated at three new fields. China, one of the few major economies with ample petroleum to meet domestic requirements, exported 20,000 b/d to Japan in 1973 and will raise that figure to as much as 100,000 b/d in 1974. In contrast, coal, which accounts for 80% of all primary energy produced in China, will remain in tight supply.

Military Production

Growth in military production will depend mainly on the rate at which the Chinese decide to develop their strategic offensive missile forces and the extent to which the aircraft industry recovers from the production cutbacks of the past few years.

Perspective

Whereas China in the next few years will be drawing still farther ahead of other major less developed countries such as India, Pakistan, and Indonesia, the PRC probably will not be gaining ground on the high-technology economies.

A Caveat

These judgments about Chinese economic prospects for 1974-75 rest on an analysis of important policy changes made in Peking in late 1972 and early 1973 -- for example, changes in the policies toward imports of food, reliance on foreign equipment and technology, and borrowing from abroad. These new policies have a strong momentum that ought to carry through the next two years. Yet straight-line projections of Chinese economic affairs are hazardous in view of past economic reverses caused by sudden political upheavals.*

* Unclassified economic indicators for the Chinese economy are presented on page 2 in the text. For a detachable copy of these unclassified data, see the final page of this memorandum.

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DISCUSSION

1. In spite of unfilled top administrative posts and intensified political wrangling, the Chinese leadership was able to make some key economic decisions in late 1972 and early 1973.

- To offset the poor 1972 harvest and to maintain food and cloth consumption, the government sharply increased imports of grain and cotton;
- In order to boost capacity for the production of chemical fertilizers and artificial fibers and to give a fillip to industrial modernization, Peking quickly consummated negotiations for an unprecedented number of expensive Western industrial plants; and
- The autarchic policy of no foreign indebtedness was tacitly relaxed when Peking arranged to finance two-thirds of its purchases of industrial plants through deferred payments.

2. These decisions came near the middle of the Fourth Five-Year Plan (1971-75). Policy at the onset of the plan had stressed economic self-sufficiency, the rapid but controlled development of small-scale industry, the continuation of strong support to the agricultural sector, and the balancing of rising imports by rising exports. Early in the plan, substantial catchup gains in the economy were made by taking up the slack in the economy caused by the Cultural Revolution. Later, even without the help of published statistical data, observers of the economy could sense that problems were piling up for the Chinese leadership, such as (a) the pronounced drop in agricultural production in 1972, (b) the strain on raw materials and labor supply attributable to the proliferation of small plants, (c) the inability to move forward as smartly as scheduled in electronics and other high-technology fields, and (d) lags in investment in the extractive industries.

3. The subsequent changes in policy have a momentum that will carry into 1974-75 and beyond. Three-year grain contracts with Canada, Australia, and Argentina extend into 1976. The modern plants now being ordered will not come on stream until the late 1970s, and debt servicing will affect the Chinese balance of payments for several years to come. A formidable political tide would be required to wash out these new policies with their obvious momentum. Nonetheless, the advanced age of the ruling duumvirs and the past history of violent political struggle in China suggest caution in relying heavily on any straight-line projection of economic developments over the next few years.

People's Republic of China: Economic Indicators

	1952	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
GNP (billion 1972 US \$)	64	83	102	98	94	79	88	93	103	114	122	119	118	130	147	159	161	172
Population, mid-year (million persons)	570	641	657	672	685	695	704	716	731	747	763	780	798	817	837	857	878	899
Per capita GNP (1972 US \$)	112	138	156	146	137	113	125	131	141	153	160	152	147	159	176	185	184	191
Gross (million metric tons)	154	185	200	165	160	160	180	185	195	210	215	230	215	220	240	246	236	250
Cotton (million metric tons)	1.3	1.6	1.7	1.2	0.9	1.0	1.2	1.3	1.6	1.9	1.8	2.2	2.0	1.9	2.0	2.2	1.9	2.3
Industrial production index (1957=100)	51	100	131	165	163	109	111	123	140	159	181	149	164	202	240	271	294	319
Crude steel (million metric tons)	1.35	5.35	8.0	10	13	8	8	9	10	11	13	10	12	15	18	21	23	25
Coal (million metric tons)	64.5	130.7	220	300	280	170	180	190	200	220	240	190	205	258	310	335	357	378
Electric power (billion kilowatt hours)	7.3	19.3	28	42	47	31	30	33	36	42	50	45	50	60	72	85	93	101
Crude oil (million metric tons)	0.40	1.46	2.3	3.7	5.3	5.2	5.8	6.4	8	10.8	14	14	15	20.3	28.5	36.7	43	53
Cement (million metric tons)	2.86	6.86	9.3	10.6	9.0	6.0	5.6	6.9	9.0	11.2	12.9	11.0	11.3	13.0	13.3	13.8	14.8	15.4
Chemical fertilizers (million metric tons)	0.4	1.9	3.0	3.1	3.5	2.5	3.1	5.1	5.4	8.0	9.9	10.2	12.2	15.4	18.3	21.2	24.1	28.9
Supply	0.2	0.8	1.4	1.9	2.5	1.5	2.1	3.1	4.2	5.7	7.4	5.9	8.2	11.3	14.0	16.9	19.9	24.8
Production	0.2	1.1	1.6	1.2	1.0	1.0	1.0	2.0	1.2	2.3	2.5	4.3	4.0	4.1	4.3	4.3	4.2	4.1
Imports	1.7	28.3	30	33	38	30	25	35	38	44	48	40	40	45	50	55	60	65
Trucks (thousand units)	0	7.5	16.0	19.4	15	1	14	16	26	34	47	34	31	60	70	86	100	110
Locomotives (units)	20	167	350	500	600	100	25	25	25	50	140	200	240	260	280	200	220	240
Freight cars (thousand units)	5.8	7.5	11	17	23	3	40	59	5.7	6.6	7.5	6.9	8.7	11	12	14	15	16
Cotton cloth (billion meters)	3.83	5.05	5.7	7.5	5.8	4.0	4.2	4.5	4.9	5.4	6.0	4.8	4.8	6.5	7.5	7.5	7.5	7.5
Foreign trade (billion current US \$)	1.89	3.06	2.76	4.25	3.99	3.02	2.68	2.77	3.22	3.88	4.24	3.90	3.76	3.86	4.29	4.72	5.83	8.5
Total	0.88	1.62	1.94	2.23	1.96	1.53	1.53	1.57	1.75	2.04	2.21	1.95	1.94	2.03	2.05	2.41	3.06	4.0
Exports (a.b.)	1.01	1.44	1.82	2.06	2.03	1.49	1.15	1.20	1.47	1.84	2.03	1.95	1.82	1.83	2.24	2.31	2.77	4.5
Imports (c.i.f.)																		

Agriculture

4. In the first 13 years of Communist rule, the agricultural sector was largely left to shift for itself -- that is, to generate its own investment and to obtain increased output through the rationalization and collectivization of production. After the three disaster years of 1959-61, when this policy had come a cropper, Peking made an about-face and began to supply large and growing amounts of irrigation equipment, chemical fertilizers, pesticides, and better seeds to the agricultural sector. This new agricultural policy, which is essential to providing food and cloth to the vast population of China, continued unabated through 1973.

5. The agricultural sector had a fairly good year in 1973, with output up about 6% above the low levels of 1972. The fuzzy official claims for grain production appear to put production at a record level, as follows:

Million Tons

1971	246
1972	236
1973	250

The comeback in grain production in 1973 is attributable to increases in acreage sown to grain, 10%-20% increases in chemical fertilizer and other modern inputs to production, and unusually good harvesting conditions during the fall.

6. Prospects for increased production of grain in 1974 and 1975 are only fair, laying aside the question of weather, which remains the dominant short-run factor. The really big improvements in yield will not be forthcoming until 1976 and after, when (a) the 11 large fertilizer plants now on order from abroad start coming into production, and (b) new higher yielding varieties of seeds are more widely distributed.

7. In the interim, the regime has increased its annual imports of grain from a normal 5 million tons to 7.5 million tons in 1973 and to about 9 million tons in 1974. Peking has concluded multi-year contracts with three major suppliers -- Canada, Australia, and Argentina -- for grain imports through 1976 to bridge this transitional period. The United States supplied 4.1 million tons of China's imports in 1973 and will supply at least another 4.6 million tons in 1974. Beyond 1974, the United States, as a residual supplier, presumably will be asked to meet requirements that China's older sources of supply cannot fill. Grain imports into China during 1971-74 are as follow (million tons):

Year	Total	United States	Canada	Australia	Argentina
1971	3.0	3.0	Negl.
1972	4.8	0.9	3.9
1973	7.5	4.1	2.5	0.8	0.1
1974 (contracts)	8.7	4.6	2.0	1.3	0.8

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8. Production of industrial crops in 1973 rebounded from the depressed levels of 1972 yet remained inadequate for China's needs. Domestic output of cotton had to be supplemented by the import of more than 2 million bales (480-pound bales) in the 1972/73 crop year. Chinese officials express interest in importing 1 million to 2 million bales annually in 1974-76. Because some cotton acreage has been lost to grain, cotton yields are being pushed up mainly by larger amounts of chemical fertilizer. Furthermore, among Peking's recent purchases of foreign industrial plants are several artificial fiber plants, which will lighten the burden on agriculture in the late 1970s by reducing the demand for natural fibers. Soybeans and oilseed crops did better in 1973 than in 1972. China, which had become a heavy importer of soybeans and vegetable oils in 1973, is beginning to return to exporting soybeans.

Industry

9. Industrial production apparently increased about 8% in 1973, the same rate of advance as in 1972. The estimate of a (for China) mediocre growth rate -- which was distinctly below the hopes of the leadership -- is based on the following considerations:

- The absence of concrete statistical claims by Peking at yearend and the sober tenor of the articles published about industry;
- Complaints about the failure to complete major new additions to capacity in basic industries, such as coal, iron ore, steel, cement, and electric power;
- A slowdown in the construction of small plants and the shutting down of a number of small plants as technologically inefficient; and
- Serious shortages of raw materials for light industry caused by the poor crops of 1972.

Petroleum Prospects

10. In contrast to the lacklustre performance of industry as a whole, the pace of expansion of the rapidly growing petroleum industry was stepped up even further in 1973. Production at the Ta-ching field in the northeast continued to be vigorously pushed, and new fields -- notably Sheng-li in Shantung Province, Ta-kang in Hopei, and Chien-chiang in Hupei -- accelerated production. Increased production was sufficient not only to meet rising domestic demand but also to provide increasing quantities for export. Important progress was made in upgrading transportation and port facilities for export. At yearend 1973:

- A pipeline connecting the Ta-ching field with Dairen, the major port in the northeast, was 80% complete;
- Facilities for handling petroleum had been constructed at the port of Chin-huang-tao on the eastern shore of the Pohai Gulf;
- Other harbors were being deepened to accommodate larger tankers; and
- Larger tankers were being added to China's tanker fleet.

11. China exported 20,000 b/d of petroleum to Japan in 1973 and will expand shipments to as much as 100,000 b/d in 1974. Old fields and newly exploited fields will provide China with all the oil needed for domestic use and with additional quantities for export. The limitation on the growth of production over the next few years is production equipment and transportation facilities -- not natural resources or technology. At the moment, the Chinese are negotiating with US and Japanese firms for oil exploration and drilling equipment, pipelines, and petroleum loading equipment.

12. China will be able to increase output rapidly from known on-shore fields during the next several years. As the country moves into offshore fields, technology will become a more critical factor, particularly in the deeper waters of the East and South China Seas. Peking is showing a greater interest in both purchases of offshore exploration and drilling equipment and cooperative ventures with foreign firms for the exploitation of its offshore deposits.

Other Industrial Branches

13. Coal, which accounts for 80% of all primary energy produced in China, will continue to be in tight supply in 1974-75. Recent increases in output have been possible only because existing facilities have been operated intensively, sometimes under conditions of rapidly diminishing returns. Construction of new modern mines has been insufficient to keep abreast of industry's ever-growing demand for coal.

14. In the electronics industry, the product mix is being broadened from predominantly military output toward increased support of general industrial modernization and consumer products. This trend, which will continue into 1974-75, includes the modernization of China's telecommunications systems and television broadcasting and transmission facilities, the provision of testing and measuring equipment for industry.

the development of more advanced general-purpose computers, and the supply of larger quantities of radios and television sets.

15. In military production, the sharp rise following the Cultural Revolution has come to a halt. For reasons that are not yet clear, overall military production in 1972-73 declined by perhaps 20% below the peak 1970-71 level. Cuts in the production of military aircraft – particularly the MIG-19 jet fighter and the TU-16 jet medium bomber – account for most of the decline. The extent to which aircraft production recovers and the rate at which the Chinese decide to develop their strategic offensive missile forces largely will determine the rate of increase in military production in 1974-75.

16. Aggregate industrial production in 1974-75 will advance in the neighborhood of 8% annually if present economic policy continues. Among the fast-growing industries are oil, chemical fertilizer, and electronics. Among the laggards are coal, iron ore, basic steel, cement, and cotton textiles. The large new wave of foreign equipment, which is to spur the modernization of China's industrial sector, will have its greatest impact on output in the period beyond 1975.

Industrial Technology

17. China made substantial gains in industrial technology in 1973, and these gains will be extended in 1974-75:

- Press announcements, even when discounted for puffery, reflect creditable technological advances in electronics, machine tools, metallurgy, and other industrial branches;
- The steady stream of imported equipment and technology is being effectively absorbed into the economy and is being supplemented by increasing domestic ability in industrial design and laboratory experimentation;
- Continuing on-the-job experience of thousands of engineers and technicians has built up a technical tradition almost unknown to pre-Communist China;
- The reformed educational system, with its emphasis on practical knowledge and work discipline, is favorable in many respects to short-run economic advances;
- A second track exists for bright young scientific prospects who pursue fairly rigorous academic training and are

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brought into research institutes for advanced training; the most talented of these younger people probably will serve in the long run to replace the aging corps of top Western-trained scientists; and

- China still has the opportunity for many low-cost technological transfers from the West.

18. The technological advances of 1973 were made against a background of political factionalism, which involved the longstanding "red versus expert" dilemma. Warnings against material incentives, cloistered academic studies, elitist trappings, and even bourgeois music have not been extended to foreign technology, at least to the point where needed technology is spurned. The widening of relations with the United States has already provided access to high-technology civil aircraft and communications equipment. Chinese academics, industrial technicians, and economic bureaucrats now have greater opportunity than during the Cultural Revolution to read foreign technical literature and to talk with their Western counterparts.

19. At the beginning of 1974, China lags 5 to 20 years or more behind in the various branches of industrial technology. While China strives to catch up, the leading industrial nations drive ahead to still further technological achievements. China clearly is moving ahead in absolute terms and is outdistancing other large less developed countries such as India, Pakistan, and Indonesia. At the same time, China probably is not gaining ground on the fast-moving high-technology nations such as the United States, Japan, and the leading West European countries.

Foreign Trade

20. Worldwide inflation, the revaluation of major currencies, and an increase in grain imports and other commodity flows caused the dollar value of China's foreign trade to increase at an unprecedented rate in 1973. Total trade jumped from \$5.8 billion in 1972 to about \$8.5 billion. Imports increased to roughly \$4.5 billion, up from \$2.8 billion in 1972. Exports increased more slowly, from almost \$3.1 billion in 1972 to perhaps \$4 billion in 1973. Peking incurred a trade deficit of approximately \$500 million with the non-Communist world.

21. Sharp increases in the volume and prices of imported agricultural products and acceleration in purchases of complete industrial plants highlighted China's trade in 1973. Heavy purchasing of wheat, corn, cotton, and soybeans was the major factor in China's trade deficit with the non-Communist countries. The United States, China's largest supplier of

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farm products in 1973, moved up to the number two position among Peking's trading partners. Total Sino-US trade reached approximately \$850 million, of which about \$65 million were Chinese exports.* In 1973, China contracted for \$1.2 billion in whole plants - mainly chemical fertilizer and artificial fiber plants - from Japan, the United States, and Western Europe; Peking made use of medium-term credits to finance about two-thirds of the value of these contracts. China's export earnings in 1973 were boosted by increased rice exports at higher prices and by price hikes for most Chinese goods sold at the Spring Canton Fair.

22. China's trade in 1974 will continue to increase at a substantial rate. Peking already has signed contracts to import larger quantities of agricultural products in 1974 than in 1973. Furthermore, deliveries will begin on China's billion-dollar plant import program as well as the more than one-half billion dollars worth of other machinery and equipment contracted for in 1973. Trade with the United States in 1974 may surpass the \$1 billion level, primarily because of continued large-scale agricultural imports. Chinese exports to the United States will remain only a fraction of imports.

23. In 1974, China is continuing to negotiate for a number of industrial plants, with a total value of about \$1 billion. Discussions are now in progress, for example, for a steel mill complex to be supplied by either a Japanese or West German consortium at a price upwards of one-half billion dollars. The domestic political difficulties of the first two months of 1974 could upset the signing of new contracts and slow down the growth of new economic ties with the industrial West. On balance, however, we believe new contracts will continue to be signed through 1974-75. China almost certainly will continue to run a substantial trade deficit with the non-Communist countries. Peking will meet these deficits primarily through a combination of short-term and medium-term financing.

An Overview of Political Economy in China

24. Looked at in the broadest sense, the Chinese economy has (a) the natural resources of a superpower, (b) a sturdy, disciplinable population which is unsurpassed human raw material for the economic development process, (c) grievously high labor/land and labor/capital ratios, and (d) a hard-driving leadership determined to restore China to its rightful place in Asia and the world at large. Once minimum consumption and military requirements have been satisfied, the leadership has put China's growing resources into the expansion and modernization of industrial capacity. Yet

* The figure for Sino-US trade includes an estimate of the freight charges on Chinese imports from the United States to reflect what is believed to be Chinese statistical practice. The figure is about 15% higher than that reported by the US Department of Commerce, which quotes all trade data on an f.o.b. basis.

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economic development is not the paramount goal, for Mao values the revolutionary soul of man far above his material comfort. Thus, two political cataclysms -- the Great Leap Forward (1958-60) and the Cultural Revolution (1966-69) -- have interrupted economic development under China's Soviet-style command economy. In spite of the deep-rootedness of Communist economic institutions and practices, unanticipated political developments -- for example, changes following in the wake of Mao's death -- could once more call off all economic bets.

People's Republic of China: Economic Indicators

February 1971

	1952	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973 (Prelim)
GNP (billion 1972 US \$)	64	88	102	98	94	79	83	93	103	114	122	119	118	130	147	159	161	176
Population, mid-year (million persons)	570	641	657	672	685	695	704	716	721	747	763	780	793	817	837	857	873	896
GDP per capita GNP (1972 US \$)	112	138	156	146	137	112	125	131	141	153	160	152	147	159	176	185	184	191
Grain (million metric tons)	154	185	200	163	160	160	180	185	195	210	215	230	215	220	240	246	236	250
Cotton (million metric tons)	1.3	1.6	1.7	1.2	0.9	1.0	1.2	1.3	1.6	1.9	1.3	2.2	2.0	1.9	2.0	2.2	1.9	1.9
Industrial production index (1957=100)	51	100	131	166	163	109	111	123	140	159	131	149	164	202	240	271	294	319
Crude steel (million metric tons)	1.35	5.35	8.0	10	13	8	8	9	10	11	13	10	12	15	18	21	23	25
Coal (million metric tons)	66.5	110.7	230	300	290	170	180	190	200	220	240	190	205	238	310	335	357	373
Electric power (billion kilowatt hours)	7.3	19.3	23	42	47	31	30	33	36	42	50	45	50	60	72	83	93	101
Crude oil (million metric tons)	0.44	1.46	2.3	3.7	5.3	5.2	5.8	6.4	8	10.8	14	14	15	20.3	28.5	36.7	47	53
Mineral (million metric tons)	2.86	6.86	9.3	10.6	9.0	6.0	5.6	6.9	9.0	11.2	12.9	11.0	11.3	13.0	13.3	13.8	14.3	15.8
Chemical fertilizers (million metric tons)	0.4	1.9	3.0	3.1	3.5	2.5	3.1	3.1	3.4	4.0	3.9	10.2	12.2	13.4	14.3	21.2	24.1	28.9
Supply	0.2	0.8	1.4	1.9	2.0	1.5	2.1	2.1	4.2	5.7	7.4	5.9	8.2	11.3	14.0	16.8	19.9	24.3
Imports	0.2	1.1	1.6	1.2	1.0	1.0	1.0	2.0	1.2	2.3	2.5	4.3	4.0	4.1	4.3	4.3	4.2	4.1
Machine tools (thousand units)	13.7	20.3	30	33	38	30	23	33	38	44	42	40	45	45	50	55	60	65
Textiles (thousand units)	0	7.5	14.0	19.4	15	1	14	16	26	34	47	34	37	60	70	86	100	110
Automobiles (units)	20	167	350	500	400	100	25	25	25	50	140	225	240	260	280	200	220	240
Trucks (thousand units)	5.8	7.3	11	17	23	7	4.0	5.9	5.7	6.8	7.5	6.9	8.7	11	12	14	15	16
Woolen cloth (billion square meters)	3.83	5.03	5.7	7.3	5.8	4.0	4.2	4.5	4.9	5.4	6.0	4.8	4.8	6.3	7.5	7.5	7.5	7.5
Foreign trade (billion dollars US \$)	1.87	3.06	3.74	4.29	3.99	1.02	2.68	2.77	3.22	3.48	4.24	3.90	3.78	3.86	4.29	4.72	5.83	6.5
Total	0.98	1.42	1.74	2.23	1.96	1.53	1.93	1.97	1.79	2.04	2.21	1.94	1.94	2.03	2.05	2.41	2.86	3.5
Exports (a.b.)	1.01	1.44	1.82	2.06	2.03	1.49	1.13	1.20	1.47	1.54	2.03	1.95	1.82	1.83	2.28	2.33	2.77	3.5
Imports (a.b.)																		